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FINANCIAL PLANNERS

HOW WE INVEST YOUR MONEY

This document aims to describe our approach to the provision of investment advice, whether this is through a pension, New Individual Savings Account (NISA) or other investment 'wrapper'. It outlines our beliefs about investment which form the foundations of how we invest your money. It also includes details about how you are involved with the decisions about investing - after all it is your money.

WHY ARE YOU INVESTING?

You should understand the reasons for investing and how your portfolio is designed to meet your goals.

The world of investing can be complex and often not transparent. We believe in keeping things simple. So while there is a lot of science and evidence behind our investment philosophy and process, we are keen that every client understands our recommendations and how they fit with their own financial objectives.

The first step of any investment philosophy is to understand the customer's needs. We explore this by having a conversation with you and considering factors such as:

- your need for capital security
- your age
- your family commitments
- the need for income and / or growth and any future regular income needs
- whether there is a specific item that needs funding e.g. school fees
- your investment time horizon
- your exposure to interest rate risk and inflation risk
- the impact of charges and penalty fees
- your attitude to risk, risk tolerance and capacity for loss

When delivering investment advice, we always start with a detailed understanding of your financial planning objectives. These objectives help us make decisions about the level of investment risk that *needs* to be taken.

How much risk should you take?

A conversation about risk and its many dimensions is an important factor when investing.

When it comes to investing, risk and reward are inextricably entwined. All investments usually involve some degree of risk - it's important that you understand this before you invest.

The reward for taking on risk is the potential for a greater investment return. If you have a financial goal with a long time horizon, historically you are likely to do better by carefully investing in asset categories with greater risk, like equities (shares), rather than restricting your investments to assets with less risk, like cash. On the other hand, investing solely in cash investments may be appropriate for short-term financial goals. To help understand risk we break it down into four elements:

Investment risk. These are the risks associated with different types of investment. There are many different risks (and rewards) but common ones include: volatility – the ups and downs of investment values; liquidity risk – can you get your money back when you need it; company risk – the risk that one company goes bust; default risk – the risk that a bond doesn't pay you back; emerging market risk – the fact that some markets are less efficient and transparent.

The need for risk. All these risks might start to put you off. But even investing in cash carries risk e.g. inflation risk – your spending power goes down; default risk – your deposits may not be 100% safe. For some investors, and certainly for short term savings, cash is still likely to be the most suitable fit with your needs and objectives. However, if you have a particular goal in the future that requires your money to achieve growth above the rate of inflation, you may need to take a certain amount of risk with your money.

Your attitude to risk. Risk attitude has more to do with the individual's psychology than with their financial circumstances. Some will find the prospect of volatility in their investments and the chance of losses distressing to think about, whilst others will be more relaxed about those issues. Your previous investment experience may also affect your attitude to investment risk.

Your ability to tolerate risk / accommodate losses. If things go wrong what would that mean to your finances? You may be a risky investor but can you afford to be? You may be a risk averse investor but are you saving enough? This is about understanding your ability to withstand the market shocks that might come along, with the aim of ensuring your portfolio meets your capacity for risk.

Generally speaking, a person with a higher level of wealth and income (relative to any liabilities they have) and a longer investment term will be able to take more risk, giving them a higher risk capacity.

Your ability to tolerate risk is very different to your attitude to risk – understanding this is a key part of our investment process. A conversation with you will help inform decisions about the level of investment risk that needs to be taken and that you can afford to take, rather than simply the maximum amount of risk that you feel happy with.

We will use a **risk profiling tool** to help us begin to establish the risk profile that is suitable for you. But we will also have a conversation with you about the profile to make sure that you understand what it means and how the profile needs to change to meet your particular situation. The great benefit of the tool is that it creates an unbiased view of your risk profile, and therefore is an excellent starting point for the conversation.

How long are you investing for?

Investing for the long term is very different than saving for the short term.

While there is an understandable desire to keep things safe when investing, the corrosive impact of inflation and thus the value of investing for the long term in more risky assets are compelling.

Real assets such as equities, property and commodities historically tend to make a better investment return than the apparently safer option of cash deposits in the long run, but it isn't that simple.

In the last 50 years Equities have outperformed Gilts and cash, as shown in the following table.

Table 1. Real returns (after inflation) over 50 years (% p.a.)

Asset class	Return
UK Equities	**5.5**
Gilts	**2.7**
Cash	**1.6**

Source: Barclays Research 2013

FIGURES ABOVE REFER TO PAST PERFORMANCE. PAST PERFORMANCE IS NOT A RELIABLE INDICATOR OF FUTURE RESULTS.

But it isn't the case over every time period – for example over the twelve most recent 10 year periods going back to 1902 (1902 – 1912, 1912 – 1922 etc.) – Equity returns were better than Gilts eight times, whereas Gilts beat Equities four times. *Source: Barclays Research 2013*

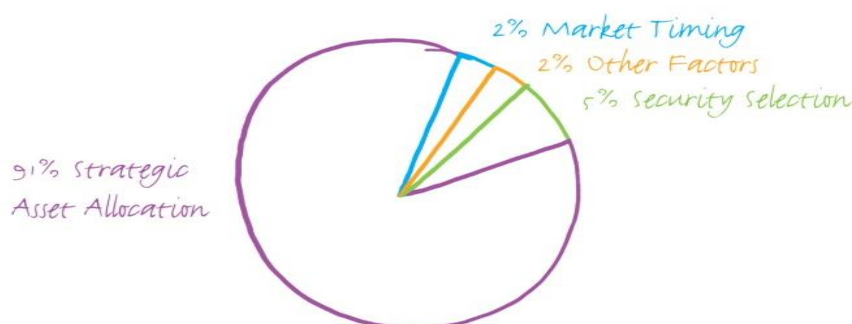
Our view is that basing investment decisions on the longer term historic behaviour of asset classes enables investors to participate in market growth; but a regular review is crucial.

Why we believe asset allocation is important

The bulk of long-term returns come from asset allocation, which means spreading your portfolio between Equities, Gilts and Fixed Interest, Property, Cash etc.

Academics will continue to argue about the precise amount of value that comes from strategic asset allocation rather than stock selection, investment style or market timing, but it is widely accepted that asset allocation has the biggest influence over the variance in portfolio returns.

Three academics, Brinson, Hood and Beebower (1986, Financial Analysts Journal), who studied the performance of 91 large US pension plans between 1974 and 1983, analysed the impact of key decisions made by investment managers: long term asset allocation (i.e. 60% in equities, 40% bonds), stock picking and short term tactical changes to the asset mix. The results concluded that 90% of return and risk in a given fund was determined by the long term asset mix, with both stock picking and short term tactical changes having a negligible impact.



This means that investors and their financial planners should be devoting the bulk of their effort to constructing the most **suitable asset allocation model**, based on individual investment objectives and individual attitude towards investment risk. This is where we focus our attention when delivering investment advice.

It's like making a cake. The most important part is making sure you have the right amount of flour, eggs, butter etc. rather than worrying whether the ingredients come from Harrods or the corner shop.

The Potential Benefits of Diversification

Diversification using mainstream asset classes can potentially reduce risk without diminishing returns.

Diversification is a strategy that can be neatly summed up by the timeless adage "Don't put all your eggs in one basket." The strategy involves spreading your money among various investments with the intention that if one investment loses money, the other investments may more than make up for those losses.

A diversified portfolio should be diversified at two levels: *between* asset categories and *within* asset categories. So, in addition to allocating your investments among stocks, bonds, cash, and possibly other asset categories, you'll also need to spread out your investments within each asset category.

We use fund managers to help build portfolios that are diversified at both asset class and stock level. But importantly they stay close to the asset allocation outcome which has been determined as appropriate for you.

How Much Do Your Investments Cost?

Costs are certain and returns are not – so they deserve your attention.

Costs are certain and fund performance is not. It therefore makes sense to reduce costs wherever it is safe to do so. One of the major issues in fund management is that not all the costs are transparent.

There are three main costs with investing in funds:

1. The Annual Management Charge (AMC) – is the fee that the manager charges;
2. The Total Expense Ratio (TER) – this is the AMC plus legal, audit, depositary, safe custody and other costs;
3. Trading costs – these are the costs of buying and selling the investments inside a fund. These include stamp duty, bid / offer spreads, stockbroker commissions, the costs of settling transactions etc.

Even though TERs are not the whole cost of running a fund, they are a powerful predictor of fund returns.

Morningstar (a large global fund ratings agency) conducted a review in August 2010 to identify the best historic predictors of performance. The results are remarkably clear:

- ***In every time period and every data point tested, low cost funds beat high costs funds***
- ***Expense ratios are strong predictors of performance. In every asset class over every time period, the cheapest quintile produced higher total returns than the most expensive quintile"***

Understanding and seeking to reduce costs, where safe to do so, is a key part of our investment process.

Making your investment tax efficient and easy to manage

Tax and the ability to view and manage your investments are important.

Making investments tax efficient is a sensible objective and wherever we can we will try to reduce the tax your investments will pay. Use of pension wrappers and NISAs will assist in this objective where appropriate.

We use platforms, also known as wraps or fund supermarkets, where appropriate, to hold your investments. These offer access to your valuations (so you can see how your investments are doing) and tax wrappers (pensions and ISAs for example). They also allow us to move your money between funds cost effectively if we need to in future.

Should you take an 'Active' or a 'Passive' approach to investing?

Active management and passive strategies can both play a valuable role in meeting your objectives.

If you're placing your money into an investment fund or funds, there are two main strategies you'll encounter - active management and passive management.

Debate has raged over the years as to which is the most effective way to invest your money. In the current 'fund universe' your choice of actively managed funds is significantly wider than passive funds. There are over 2,000 actively managed funds and only around 70 passive funds listed by the Investment Management Association (as at July 2013).

What is active management?

Actively managed investment funds are run by a professional fund manager or investment research team. They make all the investment decisions, like which companies' shares to invest in or when to buy and sell different assets, on your behalf. They have extensive access to research on different markets, sectors and often meet with the executives of companies to analyse and assess the potential for growth before making a decision to invest.

The aim with active management is to deliver a better return from the fund than the performance of the stock market or sector that the investments sit within; in other words, it aims to "beat the market".

It also means that you have somebody tactically managing your money, so when a particular sector looks like it might be on the up, or another sector has a negative outlook, the fund manager can adjust the fund holdings accordingly to maximise growth.

How does this differ from passive management?

Passive investment funds will simply track the performance of a sector or market. Essentially, passive funds do this by buying investments in the same proportion that make up a stock market index or sector. If done correctly, this will produce a return that mirrors that of the index or sector that the fund is tracking.

Passive investment funds usually offer good diversification at a much lower cost than actively managed funds. However, due to the nature of passive funds there is no potential for these funds to outperform the market.

Rather than take an evangelical view of one option over the other, we appreciate that there are arguments for both approaches and accordingly we provide advice on both active and passive investment solutions.

To use the jargon – this is about optimising your governance and risk budget – or, more simply, advising on the most suitable product to fit your needs and financial goals.

A ROBUST AND REPEATABLE PROCESS

Investment success comes from the consistent application of a robust process.

There are numerous ways to approach the construction and on-going management of an investment portfolio. Without the application of a robust process, the emotional aspects of investing can prevent investors from making the most appropriate decisions. As a firm, we consistently apply a multi-stage investment advice process designed to deliver suitable advice to every client. The outcome is tailored to meet individual objectives but the process itself is always the same.

As with any plan we need to regularly review progress to make sure we are on track. We will discuss with you the best way to achieve this and agree a course of action.

WHAT WE DON'T DO

Success is often about the things you don't do as much as the things you do.

We have some simple rules that we apply to all portfolios unless the clients specifically requests a different approach:

- No individual bonds / shares
- No direct hedge funds
- No direct unauthorised funds
- No structured products
- Only use funds run by FCA regulated managers
- We do not try and 'time markets'
- We use expert managers to help assist in selecting risk managed portfolios.

If you don't understand anything here please ask us; there is no such thing as a silly question when it comes to looking after your money!

The information contained in this brochure is for information purposes only and does not constitute advice. If you don't understand any of the contents we recommend you seek Professional Financial Advice.